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No. 02-966

In The
Supreme Court of the United States

NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PENNSYLVANIA,

Petitioner,

v.

TEXTRON FINANCIAL CORPORATION,

Respondent.

On Petition For Writ Of Certiorari To The California Court Of Appeal, Fourth Appellate District

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Does the United States Constitution limit punitive damages by imposing a mathematical formula that calculates a specific ratio of punitive to compensatory damages?

2. Does an appellate court reviewing a punitive damages award commit constitutional error when it looks to factors in addition to comparable civil and criminal penalties in determining whether an insurance company had adequate notice that its fraudulent claims handling conduct could warrant substantial punitive damages?

TEXTRON'S RULE 29.6 STATEMENT

Textron Financial Corporation is a wholly-owned subsidiary of Textron, Inc.

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INTRODUCTION

This case involves an insurance company (National Union) that fabricated policy documents after an accident to fraudulently and retroactively negate insurance coverage.

A jury assessed $10 million in punitive damages against National Union. But the trial judge reduced the punitive damages by 83%. Despite the egregious nature of the wrongdoing, and despite the trial judge's substantial reduction of punitive damages, National Union continues to challenge the result even though it has already been through the appellate process twice.[1]

The reduced $1.7 million award was well within constitutional limits. Even National Union acknowledges that the involved conduct was extreme and outrageous. After it found out about the accident, the insurance company fabricated documents to make it appear as if insurance coverage had been eliminated before the accident. This was affirmative and outright fraud. As the fraud started to surface, concealment efforts were undertaken. Documents were removed from files and destroyed. Important information was obscured. Even during the trial, National Union simply destroyed documents to keep them from the jury.

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[1] This was one of several cases in which this Court granted certiorari, vacated the judgment, and remanded in light of *Cooper Industries, Inc. v. Leatherman Tool Group, Inc.*, 532 U.S. 424 (2001). See *National Union Fire Ins. Co. v. Textron Financial Corp.*, 534 U.S. ___, 122 S.Ct. 340 (2001). On remand, the California Court of Appeal again affirmed the judgment and the California Supreme Court again denied review.

The ratio of punitive to compensatory damages was 10:1. But when the harm and potential harm that resulted from National Union's fraudulent conduct are considered, the ratio dropped to 3:1 or less. The civil and criminal penalties that attach to similar misconduct are substantial. Insurance fraud is punishable by up to five years imprisonment plus hefty fines. On the civil side, the California Department of Insurance can punish such conduct by assessing fines of up to $55,000 and, if necessary, by terminating an insurance company's license to sell insurance in California.

Even if there was room to reasonably debate whether the jury's original $10 million verdict was within constitutional limits, there was no doubt that the judicially-reduced $1.7 million punitive damages judgment was well within constitutional limits.

During the seven years this case has been on appeal, National Union's arguments have always varied and often conflicted. And if the actual facts were anything close to those National Union describes, the jury would have found in favor of National Union, not against it.

In its latest attack on a judgment that has already withstood extensive appellate review, National Union argues that the United States Constitution mandates a rigid mathematical rule placing an absolute maximum limit on a state's ability to impose punitive damages, even in situations where overt fraudulent misconduct was committed by an insurer that was required under state law to treat its policyholders with utmost good faith and fair dealing. Textron does not believe that the Constitution includes such a rigid mathematical formula. But even if it did, it would have no impact on this case. Using a correct

assessment of compensatory damages, the punitive award as reduced by the court was only a 10:1 ratio. And when the actual harm and potential harm is considered, the ratio drops to 3:1 or less.

National Union's petition should be denied. This is *not* a case where National Union was punished for out-of-state conduct. This is *not* a case involving conduct that was perfectly legal in other states. This is *not* a case where a jury assessed hundreds of millions dollars in punitive damages. This isn't even a case where the jury's verdict was allowed to stand. To the contrary, this is a case where National Union was very fortunate to have a trial judge dramatically reduce the jury's verdict even though National Union was caught engaging in post-accident policy manipulation, and even though National Union staunchly ratified and defended the wrongdoing all the way through trial. There is no issue worthy of further review by this Court.

FACTUAL BACKGROUND

This trial lasted more than a month and a half, and generated a record that exceeded 10,000 pages. Textron's task of presenting the facts is made more difficult because National Union's petition (like its prior petition in 2001) recites an incomplete and inaccurate version of events.

In early 1992, Textron loaned Il Sung Ko $87,000 to buy a tour bus for his business. To protect itself, Textron had Ko obtain insurance covering Textron's security

interest in the bus. Ko bought insurance from National Union. Textron was named as an additional insured under the policy. PA 3a.[2]

After the 1992 Los Angeles riots, Ko faced a slowing tourism business and cash flow problems. Douglas Ferguson, Ko's broker, advanced a premium payment for Ko. Nevertheless, on October 22, 1992, National Union sent Ko a cancellation notice which said the policy would cancel as of November 27, 1992. PA 4a.

Aware that Ko was not using some of the six buses in his fleet, Ferguson wrote to TRM International, Inc., National Union's managing general agent for bus insurance, and asked if a new policy could be issued "with only four units." In response to Ferguson's inquiry, George Peare, a TRM underwriter, responded by suggesting a lay-up credit, a "much easier way of doing it." According to Ferguson, discussion about the lay-up credit was limited. He was told to "Get the license plates. Get the license plates." App. 3.

Lay-up credits are a form of mileage rating. The risk of loss is reduced where fewer total miles are being driven. So an insurer that offers a lay-up credit reduces the premium when vehicles are not in regular use. Unlike deletions, lay-up credits do not eliminate or even reduce coverage. Because full coverage remains in effect, insurance companies that issue lay-up credits typically ask for

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[2] Citations to petitioner's appendix are referenced as "PA." Citations to respondent's appendix, which consists primarily of an excerpt from a brief below containing record references, are abbreviated "App."

license plates to minimize the likelihood that a laid-up vehicle will be used on a daily basis. App. 3.[3]

This lay-up credit was advantageous for National Union since it kept the policy in force, allowed National Union to continue collecting monthly premium payments of about $5,000, required very little paperwork, and did not require notice to other parties. App. 3.

A few days after the policy was cancelled for non-payment of premium (without notice to Textron), Ko made a partial premium payment and sent the license plates for two of his six buses to Ferguson. By December 2, 1992, National Union had implemented the lay-up credit, and the policy was reinstated in full, with no reduction in coverage. App. 3-4.

Ko's broker, Ferguson, did not understand the difference between lay-up credits and deletions. Ferguson thought lay-up credits and deletions were the same thing. He incorrectly assumed that lay-up credits and suspensions terminated coverage. App. 4.

Ferguson also wanted to make sure he recovered the premium he had advanced. So after National Union reinstated the policy, Ferguson continued to send notes to TRM which emphasized that he had the license plates. App. 4. However, since the lay-up credit had already been

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[3] "Deletions," on the other hand, eliminate coverage for the deleted vehicle. Deletions typically occur when a policyholder sells a vehicle to a third-party. If insurance companies made policyholders turn in license plates when coverage was deleted, policyholders would not be able to sell their vehicles. As a result, policyholders are not required to turn in license plates when the insurer deletes a vehicle from coverage.

issued, and the policy fully reinstated, TRM did not bother to respond.

Then, January 7, 1993, one of Ko's buses broke down. The Textron-financed bus was sent to pick up stranded passengers, and it was severely damaged when it hit a patch of ice and slammed into a truck. Since Ferguson erroneously believed lay-up credits eliminated coverage, he told Ko the accident was not covered. However, Ferguson presented a claim to National Union. PA 4a-5a.

Because the lay-up credit had resulted in a full policy reinstatement, TRM – the underwriting company that handled administration of bus insurance policies for National Union – verified coverage on February 4, 1993. App. 4-5. But a claims adjuster subsequently spoke to Ko's assistant (neither Ko nor his assistant spoke English as a first language). The adjuster quickly learned that Ko had erroneously been told that there was no coverage for the accident. National Union's adjuster decided not to tell Ko that coverage had already been verified, explaining that "coverage is usually, in my experience, only discussed with an insured if it's a problem." App. 5.

At least one claims adjuster wanted to review the actual policy before denying the claim. Claims adjusters had been instructed to contact John Lavin (an underwriting manager in National Union's Home Office) "for a complete policy copy." The claims office did request a copy of the policy, but National Union's Home Office refused to release the policy, even to its own adjusters. App. 5.

Because National Union's Home Office refused to allow access to the actual policy, claims personnel turned to the TRM claims supervisor, Dick Longuil. But Longuil worked in New York, eight hours away from TRM's New

Jersey office. As a result, Longuil did not have access to any file materials. App. 5.

Even without documents, however, Longuil immediately had "a bad feeling about" the accident. Among other things, he was troubled by the possibility of personal injury claims that could become very costly for National Union. App. 5-6.

A few days later, even though TRM had previously verified coverage, National Union denied Ko's claim (and the claim that had been presented for the owner of the truck the bus had hit). National Union said coverage had been cancelled before the accident. The claims were denied even though TRM had verified coverage; even though the policy had been fully reinstated before the accident; and even though the insurance policy National Union maintained at its Home Office included a lay-up credit endorsement, and no deletion endorsement. PA 5a-6a.

As of February 1993, no one had told Textron about the policy cancellation, the lay-up credit, the policy reinstatement, the accident, or the coverage verification. App. 6.

Ko continued making loan payments as long as he could. But by late 1993, he defaulted on his Textron loan. Textron then learned that the bus had been involved in an accident earlier that year. When it inquired, Textron was falsely told that coverage was terminated before the accident. As a result, Textron was required to sue Ko. But without insurance for the loss, Ko was soon forced into bankruptcy. PA 5a.

National Union formally denied Textron's claim based on the false contention that National Union couldn't tell

Textron about the coverage termination because National Union itself did not have advance notice of the cancellation. National Union's denial letter did not disclose the lay-up credit, the reinstatement, or the fact that coverage had been verified after the accident. App. 6.

Textron had started asking for a copy of the National Union insurance policy in January 1994. Two months later, in March 1994, National Union finally gave its own claims adjusters a copy of the original Home Office policy. But National Union decided to withhold the policy from Textron. App. 6.

Rather than give Textron a copy of the original policy, National Union waited another five months and then it gave Textron a different version of the policy. This new version of the policy conveniently replaced the credit endorsement with a falsified "deletion" endorsement – a falsified document that had been created long after the accident. PA 5. No witness who testified at trial could offer any legitimate reason why National Union would withhold the original Home Office policy from Textron. App. 7. The jury had no choice but to conclude that National Union's Home Office was trying to conceal the fraud by keeping that version of the policy away from Textron.

Textron sued National Union in August 1994. National Union adopted an unusual litigation strategy. It embraced and endorsed everything TRM did (except when TRM verified coverage). Instead of arguing that TRM had defrauded everyone, National Union accused Textron of trying to "set up" the claim. While blaming Textron, National Union praised TRM, telling the jury "TRM did what it did openly, candidly, without trying to fool anybody."

National Union was so antagonistic toward Textron that even after TRM officially acknowledged that a lay-up credit issued following a request for license plates would not terminate coverage, National Union continued to attack Textron and continued to deny Textron's claim for insurance benefits.

By the end of the trial, everyone in the courtroom knew National Union had been caught perpetrating a serious fraud. National Union had issued a lay-up credit and fully reinstated the policy *before* the accident. There never was any pre-accident "deletion." But because it was worried about possible personal injury claims that might have come from passengers on a seriously damaged tour bus, and because it knew Ko could barely speak English and his broker did not know about lay-up credits, National Union had fabricated and concealed documents to fraudulently and retroactively terminate coverage.

From start to finish National Union tried to conceal evidence and deceive Textron and others. When it started responding to Textron's claim, National Union chose not to mention important facts, such as the fact that the policy had been fully reinstated before the accident. App. 8. To prevent Textron from learning that the fabricated deletion endorsement had been created after the accident, a "certificate of mailing" was placed over the purported creation date before the falsified "deletion" version of endorsement No. 8 was faxed to Textron. App. 8-9.[4]

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[4] The "certificate of mailing" offered further evidence of deception. For example, there was no corresponding "certificate of mailing" for the other bus that was supposedly "deleted." If National Union had been

(Continued on following page)

Similarly, National Union's Home Office withheld the original policy, because even as of October of 1993 (nine months after the accident), there was still no "deletion" endorsement in the actual policy – only a credit endorsement. App. 7.

During trial, the jury also learned that National Union's underwriting file had been manipulated before it was produced to Textron. The file manipulation was exposed because Ferguson's file included lay-up credit-related correspondence that had been removed from the underwriting file. For example, Exhibit 15 was the underwriter's "much easier way of doing it" letter. The "much easier way of doing it" obviously referred to a lay-up credit. But Exhibit 15 (and other similar documents) had been removed from the underwriting file before the file was produced to Textron. App. 9-10.

Even in mid-trial, National Union destroyed documents to keep them from the jury. For example, National Union's Portland claim file was housed in a jacket that would have reflected important claims information. Nevertheless, National Union produced only part of the file, explaining that "some idiot" had destroyed the file's jacket before it could be made available to Textron. There was no legitimate reason to destroy the jacket. In fact, without the jacket, there was nothing to hold the file together. App. 10.

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providing routine "deletion" notices, it would have prepared "certificates of mailing" for both buses, not just the bus that had been involved in an accident. App. 9.

The evidence permitted only one reasonable conclusion – that National Union had perpetrated a serious fraud and then tried to cover it up. In fact, the conduct was so egregious that even National Union's own attorney conceded during closing arguments that unless the jury believed National Union's witnesses, this conduct was "vile."

In addition to insurance bad faith, the jury determined that National Union committed fraud through both affirmative misrepresentation and concealment. Applying California's heightened clear and convincing evidentiary standard, the jury also found that National Union acted with malice, with fraud *and* with oppression.

POST-TRIAL PROCEDURAL HISTORY

Following trial and entry of judgment, National Union moved for a new trial and asked the trial judge to reduce the jury's verdict based on *BMW of North America v. Gore*, 517 U.S. 559 (1996).

Ironically, the trial judge acknowledged the obvious reprehensibility of the misconduct, but reduced the jury's punitive damages verdict from $10 million to $1.7 million despite observing that:

> Surely National Union does not contend, nor can it, that it did not have fair notice that the breach of the covenant of good faith and fair dealing could result in the imposition of substantial punitive damages under the common law.

PA 76a.

When it appealed the ruling, National Union made a wide array of sometimes contradictory arguments. National Union started with a laundry list of arguments centered squarely on state law issues – such as jury instructions pertaining to the state law definition of a "managing agent," common law principles of "offset" and ratification, and various state law standards for tort liability.

In its unpublished opinion, the Court of Appeal affirmed, disposing of a wide array of issues National Union had raised. The California Supreme Court denied National Union's petition for review. PA 78a-79a.

National Union then petitioned this Court, questioning the standard of review the California Court of Appeal had applied. Without issuing any opinion, this Court vacated the judgment and returned it to the California Court of Appeal for further evaluation in light of *Cooper Industries, Inc. v. Leatherman Tool Group, Inc.*, 532 U.S. 424 (2001). See *National Union Fire Ins. Co. v. Textron Financial Corp.*, 534 U.S. ___, 122 S.Ct. 340 (2001).

The California appellate court's second review of this case unequivocally applied a "de novo" standard of review. The court again decided that the $1.7 million punitive damages judgment was constitutional even if the jury's original $10 million verdict was questionable. PA 27a-32a. Having obtained its undeniably independent review, National Union was still unsatisfied. It again petitioned the California Supreme Court for further review. National Union argued that the court of appeal had "failed to conduct a de novo review." And it argued that even the substantially reduced $1.7 million punitive damages judgment was excessive because National Union could not have had fair notice of the fact that the post-accident

fraudulent manipulation of the insurance policy could result in a punitive damages award approaching $2 million. Predictably, the California Supreme Court denied National Union's petition for review. PA 80a.

Now, having already forced Textron to incur legal fees and expenses that approximate the $1.7 million punitive damages assessment, National Union files yet another certiorari petition.

REASONS WHY NATIONAL UNION'S PETITION SHOULD BE DENIED

National Union does not argue that this case satisfies the traditional and accepted standards for invoking this Court's discretionary review. Indeed, this was an unpublished appellate court decision followed by a summary denial of review in the state's supreme court.

Having run out of arguments, National Union now suggests that the Constitution includes a rigid mathematical formula that is mechanically applied to constrain all punitive damages awards. This is not and should not be the law, so there is nothing to "clarify" and no need for "guidance." See petn. at 12, 16.

1. THE DUE PROCESS CLAUSE CANNOT BE REDUCED TO A SIMPLE MATHEMATICAL FORMULA

Having failed to convince any court that there was any constitutional problem with the $1.7 million punitive damages judgment in a case where the insurance company was caught changing an insurance policy after an accident in order to try to avoid a series of accident-related claims,

National Union now argues that the Constitution should be interpreted to impose a rigid mathematical formula that limits all punitive damages assessments.

There are at least two basic problems with National Union's argument. First, the Constitution does not include a rigid mathematical formula that mechanically caps all punitive damages awards. Second, even if the Constitution included such a mathematical formula, it would not be operative in this case. To try to make the ratios look bigger than they really are, National Union has misstated California law. And National Union has ignored the harm and potential harm courts consider when evaluating punitive damages awards.

A. The Constitution Does Not Impose a Rigid Mathematical Formula

As this Court reiterated in *BMW of North America, Inc. v. Gore*, 517 U.S. 559, 582 (1996), "we have consistently rejected the notion that the constitutional line is marked by a simple mathematical formula, even one that compares actual *and potential* damages to the punitive award." (Original emphasis.)

One court explained the problem with the rigid mathematical formula National Union advocates as follows:

> A mechanical ratio, such as two to one or three to one or four to one or even ten to one, would not make good sense. The smaller the compensatory damages, the higher the ratio of punitive to compensatory damages has to be in order to fulfill the objectives of awarding punitive damages.

Cooper v. Casey, 97 F.3d 914, 919 (7th Cir. 1996).

As a result, the ratio between the harm or potential harm caused by a defendant and the punitive damages is only one of several factors a court considers when assessing the question of whether a defendant had "fair notice . . . of the severity of the penalties that a state may impose." *BMW*, 517 U.S. at 574.

B. National Union Has Inaccurately Calculated the Applicable Ratio

Although the figure is never mentioned in National Union's petition, Textron's actual compensatory damage award was $165,414.40. PA 2a. The punitive damages part of the judgment was $1.7 million – a ratio of 10:1, *not* 20:1.

National Union seems to suggest that half of the compensatory damages should be ignored because they consist of insurance policy benefits National Union wrongfully withheld by concealing the lay-up credit that resulted in a pre-accident reinstatement of the policy. National Union says policy benefits that are wrongfully withheld are purely contractual and cannot be recovered in tort. Even if that was true (and it is not), it would not change the fact that the ratio of punitive to compensatory damages was only 10:1, not 20:1.

There are, however, other problems with the mathematical formula that serves as the basis for National Union's petition. For example, National Union's self-serving approach ignores the fact that the wrongful withholding of policy benefits causes harm. In addition, under California law, insurance policy benefits that are wrongfully withheld *are* recoverable in tort. As one court explained, "the violation of [the duty of good faith and fair dealing] sounds in tort notwithstanding that it may also

constitute a breach of contract." *Fletcher v. Western National Life Ins. Co.*, 10 Cal.App.3d 376, 401 [89 Cal.Rptr. 78, 93] (1970).

The California Supreme Court reached the same conclusion a few years later, noting that breach of "the duty of an insurer to deal fairly and in good faith . . . sounds in both contract and tort. . . . " *Gruenberg v. Aetna Ins. Co.*, 9 Cal.3d 566, 573 [108 Cal.Rptr. 480, 484] [510 P.2d 1032, 1036] (1973).

In *Brandt v. Superior Court*, 37 Cal.3d 813, 817 [210 Cal.Rptr. 211, 213] [693 P.2d 796, 798] (1985), the California Supreme Court again held that when an insurer unreasonably withholds policy benefits, the policyholder has a "cause of action in tort" and the insurance company is "liable for any damages which are the proximate result of that breach."

National Union refused to pay the policy benefits that were due and owing to Textron even though TRM had verified coverage after the loss. The jury found that National Union committed the tort of bad faith when it withheld those policy benefits. In addition, the jury found that National Union committed fraud through various concealments and overt misrepresentations. National Union was liable not just for insurance bad faith (which is itself a tort in California), but also for outright fraud. Altogether, the compensatory damages were $165,414.40. Even when the ratio is limited to a consideration of the actual compensatory damages award, the ratio is only 10:1, *not* 20:1.

As National Union has reluctantly acknowledged, ratios substantially in excess of 10:1 are routinely upheld in situations where defendants have been caught trying to

use fraud and deceit to make money. For example, in *TXO Production Corp. v. Alliance Resources Corp.*, 509 U.S. 443 (1993), this Court upheld a $10 million punitive damages award against compensatory damages of only $19,000 – a ratio of over 500:1.

C. National Union Forgets to Evaluate the Harm and Potential Harm That Arose From Its Conduct

In assessing ratios, this Court has noted that a strict assessment of actual compensatory damages is not required. Instead, courts consider the potential harm that could have resulted because of the defendant's conduct. *TXO*, 509 U.S. at 460. When the full panoply of harm and potential harm is considered, the ratio in this case drops from 10:1 to 3:1 or even less. For example, even though Textron's attorneys spent over 1,500 hours trying to get National Union to honor the claim, the trial court capped the legal fee component of Textron's damages at just over $30,000. If the trial court had allowed the jury to award damages based on a reasonable hourly rate (or if Textron had initially hired its attorneys on an hourly basis), the compensatory damages award would have approached or exceeded $500,000.

In addition, National Union's conduct placed Ko in bankruptcy, destroying the business relationship between Ko and Textron. And even though TRM advised National Union that it was "stuck for liability," National Union denied the third-party liability claim that was presented by the insurer for the truck the Textron-financed bus hit.

Finally, National Union concealed the lay-up credit and pre-accident reinstatement of the policy at least in

part because TRM and National Union were worried about possible passenger personal injury claims. As it turns out, the bus accident occurred while the bus was on the way to pick up passengers who had been stranded when another bus broke down, not when it was loaded with passengers. But before the fraud was implemented, TRM had advised that it was "really concerned about this accident," and "would not be surprised" by personal injury claims. As late as September 1994, National Union's Home Office was still concerned about the "potential B[odily] I[njury] claims." Fearing that the bus was loaded with passengers at the time of the accident, National Union was counting on its fraudulent conduct to help save hundreds of thousands of dollars, at the very least. So when the actual harm and potential harm is considered, the ratio drops to something approaching 1:1.

D. Other Facts Also Supported the Constitutionality of the Punitive Damages Assessment

Even National Union admits that *BMW* identified various circumstances in which very high ratios between punitive and compensatory damages may be particularly appropriate. For example, when the compensatory damages are relatively low, a higher ratio may be necessary to fulfill the function of punitive damages. Likewise, in situations where the harm is hard to precisely value, a higher ratio may be necessary to fulfill the function of punitive damages. *BMW*, 517 U.S. at 582.

Although the ultimate ratio was not high, this case involved all of the factors *BMW* identified. The compensatory award was relatively low, particularly considering that Textron was a substantial corporation and National

Union had a net worth of over $3.5 billion at the time of trial. During the trial, National Union's attorney repeatedly referred to the claim as "small" or "little." And at least one National Union underwriting official tried to convince the jury that he decided not to get very involved in the claim precisely because it was so small.

In addition, the conduct was particularly egregious. Affirmative fraud and deceit is bad enough when committed by anyone. But when the company that commits the fraud is charged with a strict duty of utmost good faith and fair dealing under state law, the reprehensibility of the wrongdoing is magnified.[5]

The harm National Union caused also had elements that were hard to value. For example, there is no easy way to place a value on the harm that was done when National Union forced Ko into bankruptcy and destroyed the business relationship between Textron and Ko.

Properly considered, the ratio between the punitive damages and harm suggested that the jury's $10 million

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[5] This Court has held that "the federal excessiveness inquiry appropriately begins with an identification of the state interest that a punitive award is designed to serve." *BMW*, 517 U.S. at 568. California has a compelling state interest in deterring state-licensed insurers from engaging in fraud as a means of unfairly and improperly denying insurance claims. The California Supreme Court has repeatedly acknowledged California's strong interest in promoting fair handling of insurance claims. *See, e.g., Egan v. Mutual of Omaha Ins. Co.*, 24 Cal.3d 809, 819-820 [620 P.2d 141, 145-146] [169 Cal.Rptr. 691, 695-696] (1979). California state law actually requires policyholders to report punitive damage awards against insurers to a state agency in order to help the state police insurers who engage in malicious conduct toward policyholders. Cal. Civ. Code § 3296.

verdict was within constitutional limits. But even if there was room to debate the validity of the jury's $10 million verdict, the reduced $1.7 million judgment fits well within constitutional limits.

2. THE CALIFORNIA COURT OF APPEAL PROPERLY APPLIED THE THIRD *BMW* GUIDEPOST

National Union also argues that the California Court of Appeal misapplied the third *BMW* guidepost – criminal or civil penalties that might be assessed for similar misconduct.

National Union starts by trying to divorce the guidepost from its ultimate function. The reason other criminal and civil penalties are considered is to evaluate whether the defendant had adequate notice that misconduct of the type proved at trial could result in a multi-million dollar punitive damages assessment. *BMW*, 517 U.S. at 574. Then National Union compounds its error by arguing that there is no misconduct to evaluate. As National Union tells the story, only TRM did anything wrong. And although TRM was National Union's managing general agent, and although the acts of a managing general agent are considered to be those of the insurer itself under California law, National Union simply declares that it is blameless and cannot be evaluated under the third *BMW* guidepost.[6]

The assumption underlying National Union's argument that "it can't be punished because it didn't do anything

[6] Under California law, "the acts of the [managing general agent] are considered to be the acts of the insurer on whose behalf it is acting." Cal. Ins. Code § 769.85.

wrong" is inaccurate and invalid. It is well settled that punitive damages can be assessed against an insurance company because of the actions of its agents or managing agents. So even if National Union had never become directly involved in denying the claim or manipulating the policy, and even if it had not repeatedly ratified all of the wrongful conduct, National Union would still be subject to punitive damages.

For example, this Court upheld a significant punitive damages award in a case involving an insurance sales agent's conduct. *Pacific Mutual Life Ins. Co. v. Haslip*, 499 U.S. 1 (1991) (approving punitive damages award equal to 200 times out-of-pocket expenses based on an insurance company's sales representative's conduct).[7]

In addition, the California Court of Appeal did *not* decide that TRM was the only wrongdoer. In fact, all the way through trial, National Union stubbornly defended TRM's conduct. Far from blaming TRM, National Union boldly told the jury that the important decisions were actually made by National Union's "senior brass out of New York, who were familiar with the underwriting of this

[7] In California, punitive damages can be assessed based on the conduct of "managing agents." In other jurisdictions, punitive damages can be assessed against corporations based on the conduct of agents, even if those agents are not managing agents. *See, e.g., Davis v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 906 F.2d 1206, 1221-22 (8th Cir. 1990) (approving a $2 million punitive damages award against compensatory damages of $100,000 based on conduct of a corporate agent).

claim. . . . Senior underwriters in New York who know this stuff inside and out. . . . "[8]

National Union changed its strategy on appeal. For the first time, National Union's appellate briefing started to suggest that TRM had actually committed the wrongdoing, and that National Union did not really know what TRM was doing. This, of course, was factually preposterous. It was National Union that decided to deny the claim even though TRM verified coverage after the accident. It was National Union that misrepresented the terms of the policy in the denial letter. It was National Union, not TRM, who withheld the Home Office policy that had a credit endorsement, rather than a deletion endorsement. It was a National Union underwriter, not a TRM employee, who testified that license plates are requested when lay-up credits are issued, but not when coverages are deleted. And even after TRM officially acknowledged that a request for license plates would result in a premium credit without a reduction in coverage, it was National Union that continued to deny Textron's claim.

Any doubt about who was calling the shots was removed when one of the claim managers testified that the actual decision to deny the claim was made by one of

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[8] National Union was in no position to argue that it didn't know what TRM was doing. After all, the jury saw that National Union's own documents established that National Union's "senior" management "closely monitored" the bus insurance program. Likewise, National Union was in no position to argue that it didn't know coverage had been reinstated before the accident. After all, National Union's own documents established that National Union had electronic access to up-to-date policy information, and the original policy National Union maintained revealed that there never was any pre-accident deletion.

National Union's New York underwriters, not by TRM. In fact, the same underwriter who made the decision maintained National Union's Home Office policy – the policy National Union concealed from Textron and initially, even from National Union's own claims adjusters.

Far from ruling that TRM was the only one involved in the wrongdoing, the California Court of Appeal simply observed that because TRM was a managing agent for National Union, National Union was responsible for the conduct whether it was committed by TRM or National Union's own officials. As a result, the court expressly held that there was no need to even consider the evidence demonstrating National Union's own direct involvement in the wrongdoing. PA 25a.

The wrongdoing that led to this judgment was egregious. An insurance company found out about an accident. It verified coverage for the accident. But then it figured out that Ko barely spoke English and his broker did not know the difference between a lay-up credit (which maintains full coverage) and a "deletion" (which would have eliminated coverage). The insurance company then fabricated some documents and concealed many others in an effort to perpetrate a fraud. The insurance company used fraudulent documents to deny Ko's claim, Textron's claim, and the third-party liability claim that was presented by the insurer for the truck that the Textron-financed bus hit. The California Court of Appeal correctly noted that this kind of conduct can result in a five-year prison term *plus* a fine of up to double the amount involved in the wrongdoing. Cal. Pen. Code § 550. And on the civil or regulatory side, an insurance company that engages in such conduct can be subject to substantial fines or even a loss of its

ability to do business in the state. Cal. Ins. Code §§ 790.035 & 790.07.

Nevertheless, National Union argues in its petition that the California Court of Appeal looked only to the fact that insurance companies have long been subject to potential significant punitive damages in cases involving breach of the covenant of good faith and fair dealing. To the contrary, the California Court of Appeal expressly noted that fraudulent conduct by an insurance company is a felony that can result in imprisonment and serious fines. App. 30-31; cf. *Haslip*, 499 U.S. at 23 (noting that insurance fraud can result in imprisonment under Alabama law and approving a punitive damages award of more than 200 times out-of-pocket loss). In addition, California insurance companies have long known that a failure to act in good faith toward policyholders can result in significant punitive damages awards under California Civil Code § 3294. PA 31a. In making that observation, the California Court of Appeal followed *BMW v. Gore*.

As the California Court of Appeal properly observed, the $2,000 civil penalty that could have been assessed against BMW under the Alabama Deceptive Trade Practices Act would not have provided an out-of-state distributor with fair notice that its conduct might subject it to a multi-million dollar penalty because there was no "judicial decision in Alabama or elsewhere indicating that application of that policy might give rise to such severe punishment." *BMW*, 517 U.S. at 584; see App. 31. In contrast, California has long had several published judicial decisions that provide further warning to insurers as to the potential consequences of engaging in fraudulent or bad faith claims handling. PA 31a.

National Union has never argued it "lacked notice" that its conduct could result in a multi-million dollar punitive damages award. National Union could not seriously argue that it had no idea fabricating and concealing documents after an accident to try to make it look as if coverage had been removed before the accident could result in a multi-million punitive damages award. The third *BMW* guidepost was more than satisfied here.

CONCLUSION

Even if the jury's $10 million punitive damages verdict implicated constitutional questions, the judicially-reduced $1.7 million judgment did not. The post-accident doctoring of the insurance policy involved extremely reprehensible conduct. The ratio of punitive to compensatory damages was only 10:1. And when the harm and potential harm is considered, the ratio drops to 3:1 or less. The involved conduct would warrant serious criminal and civil penalties, including up to five years imprisonment and substantial fines on the criminal side, and substantial fines and potential loss of the insurer's license on the civil/regulatory side.

No one questions National Union's tenacity or willingness to fight. But this case has already been through two full rounds of appellate review. National Union is very fortunate that the trial court substantially reduced the jury's punitive damages verdict. But the trial court's significant reduction of punitive damages placed the ultimate judgment well within constitutional limits and

eliminated any conceivable reason for this Court's review. National Union's petition should be denied.

Respectfully submitted,

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IN THE SUPREME COURT OF CALIFORNIA

TEXTRON FINANCIAL CORPORATION, Plaintiff, Respondent, and Cross-Appellant vs. NATIONAL UNION FIRE INSURANCE COMPANY OF PITTSBURGH, PENNSYLVANIA, etc., et al. Defendant, Appellant, and Cross-Respondent.	**S095924** 4th Civ. No. G020323 OCSC No. 734096

* * *

ANSWER TO PETITION FOR REVIEW

* * *

Appeal from the Superior Court
County of Orange
Honorable Raymond J. Ikola

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* * *

2. STATEMENT OF FACTS

National Union's Petition presents the "facts" in a selective and partial manner, ignoring evidence it deems unfavorable. National Union draws all inferences in its own favor, though it failed to convince the jury to draw those inferences at trial. As a result, Textron's discussion of facts is necessarily somewhat extended.

A. The Major Events

In early 1992, Textron loaned Il Sung Ko $87,000 to buy a tour bus for his business. To protect itself, Textron had Ko obtain insurance covering Textron's security interest in the bus. (R.T. 862-74; Ex. 2.) Ko bought insurance from National Union. Textron was an additional insured and a designated loss payee under the policy. (Ex. 198, pp. 45, 60-61.)

After the Los Angeles riots, Ko faced a slowing tourism business and cash flow problems. Douglas Ferguson, Ko's broker, advanced a premium payment for Ko. (R.T. 653, 660.) Nevertheless, on October 22, 1992, National Union sent Ko a notice of cancellation which said the policy would cancel as of November 27, 1992. (Ex. 10.) National Union did not give Textron notice of the cancellation.

Aware that Ko was not using some of the six buses in his fleet, Ferguson wrote to TRM International, Inc., National Union's managing general agent for bus insurance, and asked if a new policy could be issued "with only four units." (Ex. 14.) In response to Ferguson's inquiry, George Peare, a TRM underwriter, responded by suggesting a lay-up credit, a "much easier way of doing it." (Ex. 15.)

According to Ferguson, discussion about the lay-up credit was limited. Peare told him to "Get the license plates. Get the license plates." (R.T. 668.)

Lay-up credits are a form of mileage rating. The assumption is that the risk of loss is reduced where fewer total miles are being driven. An insurer that offers a lay-up credit reduces the premium when vehicles are not in regular use. (Ex. 236, pp. 50-56; R.T. 1550-51, 1783, 1789-90.) Unlike deletions, lay-up credits do not eliminate or reduce coverage.[1] When issuing lay-up credits, insurance companies typically ask for license plates to minimize the likelihood that a laid-up vehicle will be used on a daily basis. (Ex. 236, pp. 39-54; R.T. 1074, 1078-79, 1156-57, 1226, 3439.)

The lay-up credit was advantageous for National Union since it kept the policy in force, allowed National Union to continue collecting premium payments of about $5,000 a month, required very little paperwork, and did not require notice to other parties. In contrast, vehicle deletions would have required notice to Textron, other lenders, various public entities, and the City of Los Angeles. (Ex. 198, pp. 60-61, 95-96, 99.)

A few days after the policy cancelled for non-payment of premium (without notice to Textron), Ko made a partial

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[1] Deletions, on the other hand, eliminate coverage for the deleted vehicle. As a result, policyholders are not required to turn in license plates when the insurer deletes a vehicle from coverage. (R.T. 1690-91, 1697-98.) Deletions typically occur when a policyholder sells a vehicle to a third-party. (R.T. 832, 3932.) If insurance companies made policyholders turn in license plates when coverage was deleted, policyholders would not be able to sell their vehicles. (R.T. 1078-79, 1226, 3439.)

premium payment and sent the license plates for two of his six buses to Ferguson. Ferguson wrote to TRM on December 1, 1992, saying he had the plates for the "2 vehicles which are being deleted (suspended)." (Ex. 19.) The very next day, a lay-up credit was implemented and the policy was reinstated in full, with no reduction in coverage. (Ex. 20.)

Ko's broker, Ferguson, did not understand the difference between lay-up credits and suspensions, on the one hand, and deletions on the other. (R.T. 668-69.) Ferguson thought lay-up credits, suspensions, and deletions were all the same. (R.T. 690.) He incorrectly assumed that lay-up credits and suspensions terminated coverage.

Ferguson also wanted to make sure he recovered the premium he had advanced. So after National Union reinstated the policy, Ferguson continued to send notes to TRM which emphasized that he had the license plates. (Ex. 23.) However, since the lay-up credit had already been issued and the policy fully reinstated, TRM did not bother to respond.

On January 7, 1993, one of Ko's buses broke down. The Textron- financed bus was sent to pick up stranded passengers, and it was damaged in an accident. (R.T. 1347, Ex. 34.) Since Ferguson erroneously believed lay-up credits eliminated coverage, he told Ko (and his assistant, Mr. Adeyemo) the accident wasn't covered. (R.T. 695.) Nevertheless, after talking to a TRM claims supervisor, Dick Longuil, Ferguson presented a claim to National Union's adjusting affiliate, American International Adjustment Company (AIAC). (R.T. 695-97, 706-06.)

Because the lay-up credit had resulted in a full policy reinstatement, TRM verified coverage for the accident on

February 4, 1993. (Ex. 33.) But a Portland-based claims adjuster subsequently spoke to Ko's assistant and learned that Ko erroneously believed there was no coverage for the accident. The adjuster decided not to tell Ko's assistant that coverage had already been verified, explaining that "coverage is usually, in my experience, only discussed with an insured if it's a problem." (R.T. 1481.)

Claims adjusters had been instructed to contact John Lavin (an underwriting manager in National Union's Home Office) "for a complete policy copy." (Ex. 99.) The claims office did request a copy of the policy, but the request was refused. (R.T. 1464, 1506.)

Because National Union did not give adjusters access to the actual policy, claims personnel turned to a TRM claims supervisor, Dick Longuil.[2] But Longuil worked in New York, eight hours away from TRM's New Jersey office. (R.T. 697, 1647-48.) As a result, Longuil did not have access to the policy or any other file materials.

Even without documents, Longuil immediately had "a bad feeling about" the accident. (Ex. 26.) He was concerned about notice requirements (that obviously had not been

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[2] Throughout its Petition, National Union incorrectly argues that TRM had no involvement in claims. Actually, TRM had a staff claims supervisor, Dick Longuil. (R.T. 695.) TRM was deeply involved in one of the most important claim functions, verifications of coverage. (Ex. 33.) And National Union's claim representatives acknowledged that with respect to certain claim functions, TRM was "the only one that we have to rely on when it gets to this account." (R.T. 2832.) So it isn't surprising that TRM's president was a participant in the conference call that resulted in the final denial of Textron's claim. (R.T. 3108-12.)

satisfied), and the possibility of personal injury claims. (Ex. 30.)

Without giving adjusters a copy of the policy, National Union denied all claims pertaining to the accident on February 24, 1993. (Ex. 43.) The claims were denied even though coverage had been verified, and even though there were no documents or electronic information showing any "deletion." (Ex. 505; R.T. 2638-41.)

As of February 1993, no one had told Textron about the policy cancellation, the lay-up credit, the policy reinstatement, the accident, the coverage verification, or the denial of Ko's claim.

Ko continued making loan payments as long as he could. But by late 1993, Ko defaulted on his Textron loan. Textron then learned the bus might have been involved in an accident earlier that year. (R.T. 883-86, 996.) When it inquired, Textron was falsely told that the bus coverage was deleted before the accident. (R.T. 884.)

Textron presented its formal written claim by letter dated January 25, 1994. (Ex. 51.) Textron noted that it was not told about coverage termination until late in 1993. Textron's claim was denied, based on the false contention that National Union couldn't tell Textron about the coverage termination because National Union itself did not have advance notice of the cancellation. (R.T. 2325-27.) The denial letter did not disclose the lay-up credit, the reinstatement, or the fact that coverage had been verified after the accident. (Ex. 59.)

Textron started asking for a copy of the policy in January 1994. (Ex. 51.) Two months later, in March 1994, National Union finally gave its own claims adjusters a

microfiche copy of the original Home Office policy. (R.T. 606-07.) National Union decided to withhold it from Textron. (R.T. 2336, 2914, 3193, 3221.) Why did National Union refuse to let Textron see a copy of the original policy? Because the original policy had a credit endorsement, but no "deletion" endorsement. Rather than giving Textron a copy of the original policy, National Union gave Textron a different version of the policy. The new "certified" version of the policy replaced the credit endorsement No. 8 with a "deletion" endorsement No. 8.[3] (Ex. 78 p. 42, 198 p. 67; R.T. 968-70, 978-80, 2312-13.)

No witness who testified at trial could think of any legitimate reason for National Union to refuse Textron's request for the readily available original policy, while making Textron wait for a new and different version of the policy. (R.T. 3279, 3447-48.)

Meanwhile, in July 1994, National Union convened a conference call involving John Lavin (the underwriting manager charged with day-to-day supervision over TRM and responsibility for National Union's Division 20), Tom Spangenberg (TRM's president), and Ella Quinlan (a local

[3] The deletion endorsement was dated February 11, 1993. However, it was apparently created after October 5, 1993. The original policy was microfiched twice – once on March 3, 1993, and then again on October 5, 1993. (Ex. 198, p. 73, 88.) Since the original policy had no deletion endorsement, the inescapable inference was that the "deletion" endorsement was created at some point after October 5, 1993. This explained why the Portland claim file did not include a copy of the endorsement. (Ex. 505.) It also explained why Textron didn't receive a copy of the purported "deletion" endorsement until December of 1993. (Ex. 56; R.T. 946-47.) And it also explained why Ko (and his assistant, Adeyemo) did not receive any "deletion" version of endorsement No. 8. (R.T. 1356.)

claims manager). (Ex. 68, p. 2.) After concluding the lengthy conference call, Quinlan called Textron's counsel to say that Mr. Lavin was "adamant" that Textron's claim would never be voluntarily paid. (R.T. 2897-98, 3078.)

In August 1994, Spangenberg wrote to Don Schmitz, a National Union Home Office claims official. He described the incident as a "fiasco," and acknowledged the request for license plates. (Ex. 80.)

Textron sued National Union in August 1994. The jury found fraud by National Union. The findings included both affirmative misrepresentation and concealment. (C.T. 3714-21.) The jury also found National Union had acted in bad faith, and that it was guilty of malice, fraud *and* oppression. The jury awarded $10 million in punitive damages. (C.T. 4052-60.)

With these basic facts in mind, Textron briefly discusses several other parts of the record National Union has failed to discuss in its Petition.

B. National Union's Concealment Of Evidence And Deception

From start to finish National Union tried to conceal evidence and deceive Textron and others. When it started responding to Textron's claim, National Union chose not to mention important facts, such as the fact that the policy had been fully reinstated on December 2, 1992. (Exs. 20 & 59.) To prevent Textron from learning that the fabricated deletion endorsement had been created after the accident,

a "certificate of mailing" was placed over the purported creation date before the "deletion" version of endorsement No. 8 was sent to Textron. (Ex. 189; R.T. 614-15.)[4]

During the conference call where National Union's underwriters ordered denial of the claim, National Union decided to retain attorneys to try to shield documents from discovery. (Ex. 68, p. 2, R.T. 3622-23.) Then, instead of giving Textron a copy of the policy, National Union gave Textron a different version of the policy – a version which substituted a "deletion" endorsement for the lay-up credit endorsement.

During trial it also became clear that National Union's underwriting file had been manipulated before it was given to Textron.[5] The file manipulation was exposed because Ferguson's file included lay-up credit-related correspondence that had been removed from the underwriting file. For example, Exhibit 15 was George Peare's "much easier way of doing it" letter. The "much easier way of doing it" obviously referred to a lay-up credit. But

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[4] The "certificate of mailing" raised other serious questions. National Union incorrectly argued that this "certificate of mailing" showed that a "deletion" endorsement had been sent to Textron by certified mail, return receipt requested, in February 1993. (R.T. 2079.) But National Union never produced evidence of any return receipt, much less a return receipt signed by Textron. And curiously, there was no corresponding "certificate of mailing" for the other bus that was supposedly "deleted."

[5] Under the agreement between National Union and TRM, underwriting files were the property of National Union. (Ex. 170, ¶ 6(f).) Kay Marshall, an underwriter who worked for Lavin and Kelly in National Union's New York Home Office, verified production of the last part of the underwriting file to Textron on March 31, 1995. (R.T. 1669; C.T. 719.)

Exhibit 15 (and other documents) had been pulled from the underwriting file before the file was given to Textron. (R.T. 1623-24.)

National Union treated the Costa Mesa claim file (a file that included Textron claim materials) the same way. This claim file was Exhibit 231. It actually consisted of multiple volumes. But despite several court orders requiring production of the entire file, National Union refused to produce anything beyond the first volume of its claim file. Subsequent volumes of that claim file were never disclosed. (*E.g.*, Ex. 231; R.T. 201-09, 599, 2439-40, 2715, 3114-15; C.T. 619-21.)

During the trial National Union went so far as to destroy documents to keep them from the jury. For example, the initial 1993 Portland claim file included damaging information such as the post-accident coverage verification. National Union had improperly withheld the entire Portland claim file during discovery. But the court again ordered it produced during trial. (R.T. 204-209.)

The Portland file was originally housed in a jacket that would have reflected file transfer information, such as a transfer from the Portland claims office to National Union's Home Office in New York. (R.T. 1450-51, 2967.) Nevertheless, National Union produced only part of the file, explaining that "some idiot" had destroyed the file's jacket before it could be made available to Textron. (R.T. 2971, 3616, 4645.) There was no legitimate reason to destroy the jacket. And, in fact, without the jacket, there was nothing to hold the file together. (*Cf.*, Ex. 231.)

Attempts to deceive continued right up to the last day of trial, when National Union called a witness who tried to get the jury to believe Textron's claim had been paid (or

soon would be paid) in response to the jury's decision. (R.T. 4857-58.) Of course, to this very day, National Union has never paid any part of Textron's claim.

* * *

STATUTORY PROVISIONS INVOLVED

California Civil Code § 3294, subdivisions (a) & (c):

(a) In an action for the breach of an obligation not arising from contract, where it is proven by clear and convincing evidence that the defendant has been guilty of oppression, fraud, or malice, the plaintiff in addition to the actual damages, may recover damages for the sake of example and by way of punishing the defendant.

* * *

(c) As used in this section, the following definitions shall apply:

(1) "Malice" means conduct which is intended by the defendant to cause injury to the plaintiff or despicable conduct which is carried on by the defendant with a willful and conscious disregard of the rights or safety of others.

(2) "Oppression" means despicable conduct that subjects a person to cruel or unjust hardship in conscious disregard of that person's rights.

(3) "Fraud" means an intentional misrepresentation, deceit, or concealment of a material fact known to the defendant with the intention on the part of the defendant of thereby depriving a person of property or legal rights or otherwise causing injury.

California Civil Code § 3296:

(a) Whenever a judgment for punitive damages is entered against an insurer or health care service plan licensed pursuant to Chapter 2.2 (commencing with Section 1340) of Division 2 of the Health and Safety Code, the plaintiff in the action shall, within 10 days of entry of judgment, provide all of the following to the Commissioner of the Department of Insurance or the Director of the Department of Managed Health Care, whichever commissioner has regulatory jurisdiction over the insurer or health care service plan:

(1) A copy of the judgment.

(2) A brief recitation of the facts of the case.

(3) Copies of relevant pleadings, as determined by the plaintiff.

(b) The willful failure to comply with this section may, at the discretion of the trial court, result in the imposition of sanctions against the plaintiff or his or her attorney.

(c) This section shall apply to all judgments entered on or after January 1, 1995.

(d) "Insurer," for purposes of this section, means any person or entity transacting any of the classes of insurance described in Chapter 1 (commencing with Section 100) of Part 1 of Division 1 of the Insurance Code.

California Insurance Code § 769.85:

> The acts of the MGA are considered to be the acts of the insurer on whose behalf it is acting. An MGA may be examined as if it were the insurer.

California Insurance Code § 790.035:

> (a) Any person who engages in any unfair method of competition or any unfair or deceptive act or practice defined in Section 790.03 is liable to the state for a civil penalty to be fixed by the commissioner, not to exceed five thousand dollars ($5,000) for each act, or, if the act or practice was willful, a civil penalty not to exceed ten thousand dollars ($10,000) for each act. The commissioner shall have the discretion to establish what constitutes an act. However, when the issuance, amendment, or servicing of a policy or endorsement is inadvertent, all of those acts shall be a single act for the purpose of this section.
>
> (b) The penalty imposed by this section shall be imposed by and determined by the commissioner as provided by Section 790.05. The penalty imposed by this section is appealable by means of any remedy provided by Section 12940 or by Chapter 5 (commencing with Section 11500) of Part 1 of Division 3 of Title 2 of the Government Code.

California Insurance Code § 790.07:

> Whenever the commissioner shall have reason to believe that any person has violated a cease and desist order issued pursuant to Section 790.05 or

a court order issued pursuant to Section 790.06, after the order has become final, and while the order is still in effect, the commissioner may, after a hearing at which it is determined that the violation was committed, order that person to forfeit and pay to the State of California a sum not to exceed five thousand dollars ($5,000) plus any penalty due under Section 790.05, which may be recovered in a civil action, except that, if the violation is found to be willful, the amount of the penalty may be a sum not to exceed fifty-five thousand dollars ($55,000) plus the penalty due under Section 790.05. For the purposes of this section, the failure to pay any penalty imposed pursuant to Section790.035 which has become final shall constitute a violation of the cease and desist order. For any subsequent violation of the cease and desist order or of the court order or the order to pay the penalty, while the order is still in effect, the commissioner may, after hearing, suspend or revoke the license or certificate of that person for a period not exceeding one year; provided, however, no proceeding shall be based upon the subsequent violation unless the same was committed or continued after the date on which the order imposing the penalty pursuant to the preceding paragraph became final. The hearings provided by this section shall be conducted in accordance with the Administrative Procedure Act, except that the hearings may be conducted by an administrative law judge in the administrative law bureau when the proceedings involve a common question of law or fact with another proceeding arising under other Insurance Code sections that may be conducted by administrative law bureau administrative law judges. The commissioner and the appointed administrative law judge shall have all the powers

granted under the Administrative Procedure Act. The person shall be entitled to have the proceedings and the order of the commissioner therein reviewed by means of any remedy provided by Section 12940 or by the Administrative Procedure Act.

California Penal Code § 550, subdivisions (b) & (c) (pertinent parts):

(b) It is unlawful to do, or to knowingly assist or conspire with any person to do, any of the following:

(1) Present or cause to be presented any written or oral statement as part of, or in support of or opposition to, a claim for payment or other benefit pursuant to an insurance policy, knowing that the statement contains any false or misleading information concerning any material fact.

(2) Prepare or make any written or oral statement that is intended to be presented to any insurer or any insurance claimant in connection with, or in support of or opposition to, any claim or payment or other benefit pursuant to an insurance policy, knowing that the statement contains any false or misleading information concerning any material fact.

(3) Conceal, or knowingly fail to disclose the occurrence of, an event that affects any person's initial or continued

right or entitlement to any insurance benefit or payment, or the amount of any benefit or payment to which the person is entitled.

* * *

(c)(3) Every person who violates paragraph (1), (2), (3), or (4) of subdivision (b) shall be punished by imprisonment in the state prison for two, three, or five years, or by a fine not exceeding fifty thousand dollars ($50,000), unless the value of the fraud exceeds fifty thousand dollars ($50,000), in which event the fine may not exceed double the value of the fraud, or by both that imprisonment and fine; or by imprisonment in a county jail not to exceed one year, or by a fine of not more than one thousand five hundred dollars ($1,500), or by both that imprisonment and fine.